Crunch

Examination of Debt and Development

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The Global Cash Crunch
An Examination Of Debt And Development

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The 1980s have been called the "lost development decade" because of the debt crisis. Countries burdened by massive debts experienced negative growth as borrowing patterns, interest rates, debt restructuring and the terms of trade conspired to create a net transfer of funds from South to North. The "domino effect" became synonymous with countries defaulting on debt payments.

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Northern countries only realized the gravity of the situation as their banking institutions became exposed to bad loans. Prescriptions from the North, hailed as solutions for the South, served only to recoup Northern losses and exacerbate the situation. Positive signs emerged only after developed countries accepted their share of responsibility for the financial plight of the South.

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Much of the 1980s were wasted as North and South blamed one another. Renewed calls for increased levels of aid, lower interest rates and new methods for obtaining loans have created economic growth in many parts of the Third World. These and other methods of cooperation have to be designed to solve the debt crisis and open the door to a more viable world order. Researchers and planners in the North and South have to work together.

Focusing on the South

In today's world, debt is almost as certain as death and taxes. In Western societies, for example, few individuals get along without a credit card, mortgage or car loan. If anything, this is even more true of nation-states; national debt is ubiquitous across governments rich, poor and in-between. Indeed, the largest debtor is now the United States. But the virus which makes the rich sneeze can give the poor pneumonia.

The purpose of this essay is to examine the nature and enormity of the debt crisis. Although some developed countries, such as Canada and the United States, have huge national debts, our concern here is with the so-called Third World debt crisis. We will discuss some approaches to its solution and examine whether the crisis may already be receding. First, though, let us take a brief look at the size of the debt and attempt to discern how the problem came about in the first place.

So many owe so much to so few

The Third World debt has, for a long time, been conceived in terms of the debt of a small number of "highly indebted countries", or HICs, such as Brazil, Mexico and the Philippines. This has been the result of the media focus on the problems faced by these countries and on the problems they have posed for the western banking system. In fact, the term "highly indebted country" was used by the World Bank until 1989 to refer to a number of middle-income countries with debts large enough to pose a threat to the commercial banking system and world financial stability. Increasingly, however, the world is realizing that the problem of the debt is one confronting many of the developing countries of the South and that some countries with less sensational debt figures are nonetheless suffering greatly.

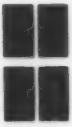
In 1988, economist Reginald Herbold Green noted that the term "debt crisis" in the North meant threats to the solvency of commercial banks and the stability of the international monetary system. "In those terms," Green declared, "it is reasonable to argue that Sub-Saharan African (SSA) states (even collectively) do not pose a 'debt crisis' because their gross commercial bank borrowing is of the order of $25 billion...." He added, however, that viewed in terms of the impact on those countries "about three-quarters of SSA's 46 states either have a fully-fledged external debt crisis or are on the brink of one."

Roy Culpeper, vice-president of the North-South Institute, an Ottawa-based think-tank, said, "The Third World debt problem has been so difficult to resolve in large part because so many developing countries have been affected, from the most impoverished countries of Africa to the relatively advanced developing nations of Latin America like Argentina and Brazil — perhaps 65 to 70 countries in all." The 109 countries covered by the World Bank's Debt Recording System (DRS) owed over US$1,340 billion — or $1.34 trillion — by the end of 1990, according to the Bank. Ten years before, the figure was less than half — about $579 billion. A decade earlier, it was an even more manageable $67 billion. According to Georgetown University economics professor John T. Cuddington, "the total external debt grew at the compounded annual rate of 24 percent between 1974 and 1980 after which the growth rate fell." By that time, of course, the lower rate was offset by the absolute size of the problem and the debt kept skyrocketing. In just one year, from 1980 to 1981, Mexico's total external debt grew from $50.7 billion to $74.9 billion, almost a 50 percent growth.

Who are the creditors?

The borrowing pattern varies from continent to continent and even from country to country. Debt owed to private banks in Western countries and other private sources was until recently central to the debt problem in Latin America. In 1985, 79.4 percent of Brazil's $101-billion debt was owed to private sources. This is changing and is now mainly true of such small Latin American countries as the Dominican Republic and Ecuador and of some other countries outside the region. Some countries are mostly indebted to official bilateral sources in developed countries. In this area, also, there has been some progress, as will be shown. The third category of debt — and the one where the least progress has been made — is that owed to multilateral banks, such as the World Bank, and the International Monetary Fund (IMF). As we shall see, differences in the structure of the national debt are as important as the enormity of the debt in developing and evaluating initiatives to resolve the crisis.

Default and rescheduling



Apart from the size and sudden growth of the debt, there are some other important manifestations of the crisis. These include default and rescheduling. They might be viewed as two sides of the same coin inasmuch as the former leads almost inexorably to the latter and the latter is often intended to prevent or correct the former. One writer has described default as usually the first sign, and sometimes a nation's deliberate signal, of the existence of a problem. The Paris Club, a group of western financial and foreign affairs officials meeting in the French capital to negotiate the rescheduling of debts owed to governments, conducted one such rescheduling in 1975. Ten years later, in 1985, the number had grown to 21. Since 1983 — the year after Mexico

signalled the existence of the crisis by announcing a debt payment moratorium — the Paris Club concluded twice as many reschedulings as it had done in all of the first 27 years of its existence. And a North-South Institute publication noted that even the decline from the peak of 21 in 1985 reflects not any diminution of the crisis but mainly "the growing difficulties of many countries in meeting the requirements for further rescheduling".

Both the need for rescheduling and the examples of default manifest the real difficulties faced by Third World debtor nations in servicing their debts. Two examples illustrate this difficulty. At the end of 1989, about a dozen countries were in arrears on their payments to the World Bank, the International Monetary Fund or both. A well-known axiom in international finance is that even if no one else is paid, the IMF and the World Bank — like the grocer and the landlord — always get paid. Therefore, a decision to default in such circumstances can only be symptomatic of economic desperation. A second, more specific example is that of Sudan which owes more than $14 billion externally including $2 billion to commercial banks. At least until recently, Sudan had made no payment on the principal of its commercial debt since 1980 and none on the interest since 1985.

This kind of situation adversely affects a developing country's credit-worthiness and, together with other factors, serves to reduce the flow of financial resources. This is particularly true of new credits from the commercial banking system. Roy Culpeper, speaking on behalf of the North-South Institute, told the Standing Committee on External Affairs and International Trade (SCEAIT) of the House of Commons in October 1989: "In 1988, negative net transfers to developing countries reached an all-time high of $50 billion, that is, more principal and interest was going out from these countries than was coming in as new finance." And Liberal Finance Critic Lloyd Axworthy told the same meeting of the Committee: "A rough estimate is that this year alone we will have a net flow-back [on interest-bearing loans] from the southern developing countries of about $1.5 billion into Canada which is virtually the same amount that we put out in foreign aid." The period 1984-89 witnessed a reverse financial flow — from South to North — taking into account private foreign direct investments, private commercial loans and official development assistance (ODA) flows.

The enormity of the debt is measurable by the burden it represents for national economies — a burden expressed by economists in terms such as the debt-GNP, debt-export and debt service ratios. The latter says what percentage of a country's export earnings in a given year is required to pay the principal and interest due in that year. According to World Bank figures, the total external debt (EDT) of the 100-plus DRS countries was about 14 percent of GNP and 142 percent of exports of goods and services (XGS) in 1970; 28 percent of GNP but only 131.1 percent of XGS in 1980; and a much increased 51.7 and 227.9 percent, respectively, in 1987. The respective figures were expected to be 38.4 percent and 176.2 percent in 1991. For 1987, the figures for the countries of Sub-Saharan Africa were

99.8 and 359.6 percent respectively. Even in 1991, the figures for this region were expected to be 106.1 and 340.8. The 1991 debt export ratio figures for Africa were expected to vary from less than 30 percent in Botswana to about 3,000 percent in Somalia.

The debt service ratio establishes the relationship between what is payable and what is earned in a particular year. It is like a family determining how much of its current earnings will be needed to meet its due and payable debts. Argentina's debt service ratio of about 75 percent in 1980 meant it would take three quarters of all its 1980 export earnings to cover that part of its debt that was due and payable that year.

Another manifestation of the debt crisis — one of interest to both debtor and creditor — is the value of the debt on the discount market. As a whole, the discounted value of the Third World debt was calculated, during much of 1991, as much less than 50 cents on the dollar, under 40 cents by some estimates. At one stage, the Peruvian debt was valued at no more than five cents on the dollar. This high level of discount has implications for the balance sheets and the financial strategies of creditor banks and for creditor nations generally. It is also an indication of the low level of debtor-country creditworthiness (referred to above) and, therefore, of their reduced ability to attract further financial inflows.

Perhaps, the most disconcerting feature of the debt crisis has been its longevity. Its first manifestation was greeted with assumptions that with an optimal blend of patience, sacrifice and fortune the problem could be made to go away. Instead, it remained, and it grew. In 1983, the World Bank was still saying that "there is no generalized debt crisis" and that the "transitory difficulties" shared by developing countries and the commercial banks could be overcome if western governments switched their emphasis from the reduction of inflation to the promotion of economic growth. In 1987, John Reed, chairman of Citicorp, the large US banking institution, was quoted as saying, "... the debt problem will be with us into the 1990s and we see nothing in the global economy that would enable these countries to get out of the situation ... the global economy is less solvent today than when the present approach was devised in 1982." For some of the large debtors in Latin America, a few positive though still tenuous signs have appeared on the horizon in recent months; however, for many other debtor countries, notably those in Sub-Saharan Africa, the debt situation remains bleak.

The Pros And Cons Of Debt Swaps And Debt Buy-Backs

The financial world now generally recognizes that rescheduling accomplishes little more than the postponement of debt repayments to another day. Often such delayed repayments must be undertaken by a future generation. However, debt swaps, in some cases, help ease the burden both in the short- and the long-term. These swaps take three basic forms: debt-for-debt; debt/equity; and so-called "debt for good works".

Debt-for-debt swaps change the creditor to whom payment must eventually be made, but do not affect the extent or nature of the indebtedness. These are transactions in which bankers exchange debt papers among themselves to facilitate their mutual convenience. For example, such an arrangement might allow one bank to consolidate its holdings in just one or two countries while permitting another to save itself the disadvantages of fetching all its eggs in one basket, or merely to get out of countries in which it has less expertise or few hopes.

The growth of such a "secondary market" for Third World debt has led to other solutions. This market assigns a value to a country's debt on the basis of how good the chances are that that debt will be paid. The new solutions include debt-equity swaps. This occurs, for example, when a bank sells its rights to a debt at a discount to a potential investor. The investor collects the debt, usually from the Central Bank, perhaps at face value or slightly less but in local currency and on the condition that the full sum would be invested in an agreed local undertaking.

The advantage of such swaps have been heralded by some, and the disadvantages highlighted by others. Debt equity swaps have been credited with being advantageous to creditor banks, debtor countries and investors. The banks benefit by receiving payment, however much discounted, on debt with doubtful repayment possibilities. A debtor country may benefit from renewed investment and possibly the reduction of its debt and, consequently, improved creditworthiness. The debtor country also enjoys the advantage that no return has to be paid to an investor unless the investment has been profitable. (In the case of a lender, on the other hand, both principal and interest fall due regardless of the fate of the project). And investors, through the discount enjoyed at the start of the process, are able, in effect, to obtain local currency, and to make their investments, at a favourable rate of exchange.

In practice, however, the system has been found to contain a number of disadvantages. Some banks have been discouraged by red tape and unclear or ambiguous regulations in their own countries or in debtor countries. Others have chosen to be so-called "free-riders," to stand aside from all debt-reduction schemes and benefit from the enhanced value of a country's debt which often follows significant debt-swap or other debt-reduction activities. From the point of view of investors — or of the banks, especially when they choose to cut out the "middleman" and acquire the equity for themselves — the main problem is one of scarcity of investment opportunities. Debtor countries have encountered a number of problems. These have included increased inflation, through the increase in the money supply needed to repurchase the debt, as well as political opposition to the loss of local autonomy with respect to key economic and social entities. Moreover, the picture of increased investment has sometimes been found to be a bit of a mirage as investors often merely undertake the same activities they would have carried out without the incentives — incentives which the debtor government provides, at some cost, through the swaps.

Not surprisingly, therefore, debt equity swaps have succeeded in liquidating not much more than one percent of the Third World debt. However, for a few specific countries, the sums involved have been significant. Debt buy-backs by Bolivia resulted in the retirement of nearly half that country's indebtedness to commercial banks. Using debt-equity swaps, Chile reduced its entire debt by about 30 percent. On the other hand, a major initiative by Mexico to entice creditor banks to accept exit bonds resulted in only a one percent reduction response.

If at the macro level, debt swaps have not proved to be a raving success, some specific projects — those called "debt-for-good-works" swaps, for example — have managed to touch the heart of the international community. Among these are a number of initiatives through which banks have donated debts to UNICEF. That organization, in turn, exchanges the debt for local currency to be used for projects to benefit children and families in developing countries. Up to March, 1991, UNICEF had received from six leading commercial banks donations of over $20 million of Sudanese debt which was then written off in exchange for the equivalent of US$2 million in local pounds. This amount is being spent to provide water supply and to improve sanitation in deprived communities in the country. And in May 1991, the Government of the Netherlands and the Netherlands National Committee for UNICEF (a non-governmental body) announced contributions of US$6.25 million for debt swap programs intended to produce about US$13 million in local currencies for children's projects in Ecuador, Honduras and Jamaica.

UNICEF believes that its "debt relief for children" (DRFC) initiative has benefited more than 100,000 persons in the Third World. UNICEF Executive Director James P. Grant said in a recent interview that the UNICEF debt swaps, "so far have been insignificant in terms of their impact on the reduction of the debt burden." He added, "However, with respect to generating local currency for children, they have generated many millions worth of local currency. This clearly is a significant plus."

Some of the UNICEF projects involve forestation and, thus, environmental protection. The first known "debt for development swap," according to Stephany Griffith-Jones and David Wainman, was used to help finance the conservation of a 25,000-acre Costa Rican jungle habitat. The conversion of debt to endowments for conservation purposes has also taken place in Bolivia, Ecuador and the Philippines. The use of debt conversion to support conservation efforts sometimes has to be pursued with caution. This has been found, for example, in the case of Brazil in view of Brazilian sensitivity regarding foreign intervention with respect to the country's environmental rights and responsibilities.

Consulting environmental planner Alan Patterson noted that such swaps were "good at promoting environmental awareness, strengthening NGOs and protecting biodiversity." He argued, however, that they were "less good at providing significant amounts of funding."

Somewhat similar to debt swaps are debt buy-backs. These happen when debtor governments themselves buy back the loans at something approximating the prevailing discounts. They include also exit bonds which permit a creditor to exchange the debt for bonds. These are new instruments offering better security to the creditor. The bonds represent, in effect, a commitment to make payment at a later date and usually at a lower rate of interest.

How did this crisis come about, anyway?

History really does repeat itself. There have been other crises of debt and default in other times but in some of the same places. In a book in 1984, Darrell Delamaide, a Paris-based financial journalist, asserts: "A peek into the history of Latin American debt is not reassuring." The author noted that the Great Depression of the 1930s had forced certain Latin American countries to renege on their debt. Further, he declared, "Latin American countries began borrowing and defaulting as soon as they gained their independence in the 1820s. ...In 1827, all of the £20 million plus Latin American bonds floated in London were in default. Nor did the situation improve with repeated reschedulings, called conversions in the case of nineteenth century bonds."

However, Delamaide added that "the fledgling nations" were in good company. "The former colonial power, Spain, started the ball rolling with its default in 1823," he said. "Portugal, Austria and Russia all left British investors in the lurch." The default on loan payments by the USA in the 1840s brought that country into such financial disrepute that Baron James de Rotschild — one of the more powerful members of a banking dynasty influencing European history for two centuries — told US presidential envoy Duff Green: "You may tell your government that you have seen the man who is at the head of the finances of Europe, and that he has told you that they cannot borrow a dollar, not a dollar."

Delamaide notes that defaulting payments together with resultant failures of central banks in Austria, Danzig (then a free German city, now Gdansk, in Poland), Hungary, Yugoslavia and elsewhere and of 10,000 commercial banks in the USA alone "in the opinion of many historians, turned a bad recession into the Great Depression." Even the French and British suspended their payments on war loans to the USA in the early 1930s.

Economics professors Barry Eichengreen and Richard Portes, specialists on debt and the Great Depression said, in 1985, that weaknesses in the international financial system in the 1920s, when the groundwork was laid for the crisis of the 1930s, could be compared to that prevailing in the 1970s, when, by most analyses, the incubation of the current crisis was completed. Eichengreen and Portes declared: "The 1920s were marked by three sets of developments which increased the international financial system's susceptibility to destabilizing shocks: flux in the foreign exchange markets, rapid institutional change in the banking system, and dramatic shifts in the volume and direction of international lending." In 1969, for a different set of reasons, former Canadian Prime Minister Lester B. Pearson, as a member of the Commission on International Development, predicted that a debt crisis would occur within a decade unless there was at least an eight percent growth in the gross capital transfers to developing countries and/or aid flows were provided on softer terms.

The Commission viewed the debt problem by examining whether the cost of servicing the existing debt exceeded the inflow of new financial resources. Rather prophetically, the members outlined a scenario in which, by 1977, debt service would match new lending in South Asia-Middle East and exceed such lending in all other areas of the developing world. One way out of the resultant crisis, in their view, was an eight percent annual increase in lending (i.e., slightly above the 1960s rate). An alternative solution was more concessional terms since "part of the explanation for the current debt problem lies in the fact that the terms of past loans were harder than the borrowing countries could bear."

Dominos

The question, says Morris Miller, was merely one of timing. There should have been little surprise, therefore, when on Friday, 13 August 1982, Mexican Finance Minister Silva Herzog arrived suddenly in Washington for talks with Treasury Secretary, Donald T. Regan, with the powerful incumbent US Federal Reserve Board Chairman, Paul Volcker, and with IMF Director-General Jacques de Larousiere. His message was simple, poignant and straightforward. Mexico was broke. It could not meet the $10 billion in payments due to the banks a few months later. Herzog requested and obtained, on his country's behalf, a three-month moratorium and billions in new credit. The date accepted as the official start of the crisis is 20 August 1982, a week later, when the suspension in bank payments by Mexico was officially announced and sent shivers through the international banking system. Because this event was merely a symptom of the malaise in the world economic system, one country after another followed Mexico along the path to either default or rescheduling.

Since then, the analyses — even what has been called a "witch hunt" in banking, political and academic circles — have continued in search of answers. Why did it happen? Who is to blame? Some have blamed developing country governments for exorbitant borrowing. Others fault western banks for injudicious lending. Some say both are responsible. Yet others point to deficiencies in the international economic system, including unequal North-South relations.

For MIT economics professors Rudiger Dornbusch and Stanley Fischer the question of the origin of the crisis is "easily answered" Say Dornbusch and Fischer, "Imprudent borrowing policies in the debtor countries and imprudent lending by commercial banks had a chance encounter with extraordinarily unfavourable world macroeconomic conditions that exposed the vulnerability of the debtors and the creditors."

The impact of petro dollars

Just when non oil-producing developing countries seemed threatened by the "first oil shock" (1973-74), the extra money made available as a result of that very shock provided much relief and fed the process of deliberate debt build-up. Western banks were anxious to provide "sovereign loans" (loans given to or guaranteed by foreign governments) to countries in the South. The banks pursued this policy because of their excess "petro dollars", their desire to expand and diversify their portfolio through increased international "exposure" and their confidence born of the knowledge that sovereign borrowers, unlike companies or individuals, did not go bankrupt. The "sovereign borrowers" were attracted, among other things, by the reduced conditionality which accompanied commercial transactions. The reasons for this preference ranged from the noble (a chance to exercise in project selection and management the sovereignty previously acquired in the political sphere) to the unsavoury (a greater facility to cream off, improperly and illegally, part of the financial flows to establish personal nest-eggs, perhaps in some of the very banks providing the loans).

The 1970s were characterized by both "rapid institutional change in the banking system" and "dramatic shifts in the volume and direction of international lending" which, as suggested above, were two of the three constituent elements of a pre-crisis scenario. The growth of commercial bank lending in the 1970s was so dramatic that such lending overtook official capital flows. Thus, at one stage half of the debt of the 17 highly indebted countries (HICs) — a third of the Third World debt generally — was owed to commerical banks. The commercial banks' share in Chile's external debt grew from 19 percent in 1974 to 80 percent in 1981. Euro-dollar lending to Third World countries rose from $4 billion in 1973 to $50 billion dollars in 1980.

The Euro-dollar market, based on the deposit of US dollars in banks outside the USA, became increasingly important in recent decades because of a number of factors. For example, currency restrictions in the US and other countries did not apply to Euro-dollars. Furthermore, the Euro-dollar market was regarded as a valuable "resting place" for the fruits of trade surpluses of OPEC countries. This increase in Euro-dollar lending, no less than the first oil shock, helped produce the explosion in Third World debt and, therefore, helped lay the basis for the crisis.

These changes had major implications in terms of the nature and size of the debt. Commercial loans usually have to be repaid in shorter periods at higher interest rates. The latter meant that, given the "magic" of compound interest, the debt grew rapidly. In the words of Roy Culpeper, "...not all debts are equal: a $1 million loan from an aid agency is likely to be less burdensome than a $1 million loan from a commercial bank. This is because aid loans typically carry below-market (sometimes zero) interest rates and are repayable over as much as 50 years, while commercial bank loans almost always charge market rates of interest and mature within five to 10 years."

Rising interest rates

Equally significant were the provisions for variable interest rates. The jeopardy for the Third World may be illustrated by the following scenario. A loan is contracted at low interest rates at a time of high inflation levels. The two factors combined could mean "negative real interest". (In other words, by the time the loan is repaid, higher prices would mean that the money, even with interest added on, could buy less than it could at the time of the loan.) However, two things happen in the interim. The rate of inflation falls and interest rates rise. Thus a loan contracted in favourable circumstances ends up being repaid under onerous terms. The debt crisis report issued by the House of Commons Standing Committee on External Affairs and International Trade gave the examples of loans contracted in 1977 at 7% interest being serviced in 1980-81 at 20% interest. Culpeper told the Committee: "Without the great spike in interest rates that took place in 1980-81, I believe there would not have been the debt crisis, at least not in anything like the magnitude we have experienced."

The Committee also spoke about such wide currency swings as the movement in value of the Japanese yen between 270 and 120 yen to the dollar. As with interest rates and the rate of inflation, changes in the value of the currency in which a loan is denominated can have a significant impact on the amount of money actually being repaid. Such loans are almost routinely repaid in "hard" Western currency — almost never in the currency of the Third World debtor country. Of course, whether a debtor country gains or loses as a result of a currency swing would depend not only on the currency in which the loan is denominated, but also on such other factors as the currency in which it is paid for its main exports.

Declining terms of trade

Then there was the "second oil shock" in 1979-80. If the effects of the first oil shock were alleviated by the inflow of "petro dollars", a number of factors conspired to ensure that the second was mitigated by no such windfall. Those factors included the greater demand for liquidity by deficit-burdened governments, such as the US Government, and for private credits and investments, in the developed countries. Banks had adequately satisfied their perceived need to diversify their loan portfolios and had revised their thinking about the creditworthiness of developing countries. Also, oil-exporting countries were now better equipped to utilize a greater share of their own surpluses than during the first windfall. As if all of these problems were not sufficient, many developing countries faced a phenomenon they escaped during much of the first oil price rise — a steep and steady fall in the export prices of other commodities. This fall in prices for exported commodities at a time of rising prices for oil and other imports is an example of what economists call deteriorating terms of trade. Author and economics professor William Cline notes that in one year alone, 1981-82, "the total loss to

non oil developing countries from deteriorating terms of trade was estimated at $79 billion".

In spite of these common international problems, most countries in Asia continued to grow throughout the 1980s. Indeed, with strong performance from the two giants of China and India, that continent actually began to grow faster than the North. While a variety of factors were at play, suffice it to say that sound economic policies had an important role. In contrast, as Bulow and Rugoff point out, "a large fraction of the growth shortfall in highly indebted countries occurred from 1980 to 1983, before the countries were required to make any significant debt repayments."

Not enough growth

Some have argued that the central issue here is growth. If developing countries had achieved a sufficiently high level of growth, they would have had no need to default in their debt servicing. According to professors Jeremy Bulow of Stanford University and Kenneth Rogoff of the University of California at Berkeley, "...the debt problem is better viewed as a *symptom* of poor growth rather than its primary cause."

Angel Gurria Trevino, who has been Mexico's chief negotiator on foreign debt, feels that if his country had taken certain corrective policy measures when the international oil price fell in mid-1981, "The debt crisis, as it erupted in 1982, could to some extent have been avoided." Whether or not one accepts this view of what constitutes cause and effect, it is clear that the Third World debt problem must be viewed in terms of its relationship to the overall growth and development of the countries and peoples of the South. And perhaps the relationship is best displayed not as a straight line but in terms of a vicious circle where unserviceable debt stifles economic growth and economic stagnation precludes debt servicing.

All are involved

In the early days of the crisis, the involvement of the North as potential fellow-sufferers with the South was, in some ways, more obvious and was reflected in the panic experienced in the realms of banking and governance in the North. Says Delamaide, the Paris-based financial journalist, "...the Mexican declaration brought to a head the monetary and financial crisis that had been brewing for more than a decade. It also brought home to the public at large, probably for the first time, the fragility of world finance." Delamaide recalls that, "in one day, the Monday after the declaration, depositors in Hartford Federal Savings and Loan in the USA withdrew $3 million — more than the total withdrawal for any month in 1981". The Hartford Federal S&L was subsequently forced to merge with another bank.

The panic extended from kitchen tables to board rooms to Cabinet offices. One writer credited the crisis with being responsible for the fall of the Federal Government in what was then West Germany.

Eventually the banks and the governments of the North devised ways to deal with at least some aspects of the crisis, while other actors, principally investment firms, took advantage of the opportunity provided by the heavy discount of the debt on the open market. The banks, after an initial reluctance to deal with the reality represented by this discount, followed a lead established by Citibank and started making provisions on their balance sheets to cover any losses resulting from a default. These provisions now typically cover 50% to 100% of a Third World debt. In the case of Canadian banks the figure has hovered around 70% during the past year or two.

Reassuring as these provisions might be for shareholders and depositors, they do have some implications for the taxpayer. Culpeper estimates that by late 1989 such provisions on the part of Canadian banks had resulted in reduced taxes for the Canadian treasury in the order of $3 billion which he considers "not insignificant given the federal deficit of about $29 billion." Culpeper emphasizes that such provisions by themselves do not reduce "one cent of what the debtor legally owes." So, the banks get the tax benefit, as well as the psychological security that comes with making the provisions, but the debtor countries concerned remain liable in full for any due payments.

Lost Jobs

Available figures do not permit precise measurement of the effect of the crisis on employment and export in the North. However, there is a considerable body of opinion that the effect is significant. According to the House Standing Committee Report mentioned earlier, the USA alone is believed to have lost $15 billion worth of exports to Latin America between 1980 and 1986. This, according to the Committee, was due to import compression in the region as a result of the negative financial flows. A study by the Overseas Development Council, a Washington based think-tank specializing on US-Third World relations, found that the USA lost 860,000 jobs because of the poor performance of US exports to Latin America in 1987; and a total of 1.8 million US jobs were lost because of the poor performance of US exports to developing countries generally. The study suggests that perhaps more than half of those job losses could be attributed directly to the debt crisis. According to a UN publication, "Another study estimates that 2-3 million jobs have been lost in Western Europe due to reduced trade with the Third World." The North-South Institute calculates that Canada has lost at least $1.6 billion in possible exports to the Caribbean and Latin America because of import cut-backs in the region resulting from the problem of the debt.

Drug trafficking and environmental degradation

The same UN publication also sees the drug trade and environmental degradation as problems exacerbated by the "economic pressures associated with debt." The UN says, "For example, residents and officials in several US cities bordering Mexico are beginning to worry about the environmental hazards created in their communities by industrial waste and accidents related to border plants encouraged as part of the government's program to boost exports." The same kind of economic pressures could lead to deforestation or soil degradation. And some Third World governments are unwilling to crack down diligently on the drug trade if it represents their most promising export sector at a time of foreign exchange crisis.

The UN publication notes that environmental problems know no national borders and adds, "There is a mad dash ... to cut down rain forests for grazing cattle, making furniture, etc. to provide more exports. Rain forest destruction is a major contributor to the 'greenhouse effect', hurting everyone on the planet — not just citizens of the countries where the deforestation occurs." Or in the words of West Indian poet Martin Carter, "All are involved/All are consumed."

In 1990, Allan Patterson, a US consulting environmental planner and policy analyst, wrote: "There can be no questioning the severe impact that the debt crisis has had on the environment in developing countries." He emphasizes, however, that "debt repayment ... is by no means solely responsible for environmental degradation." One might argue that it has more to do with a government's development priorities, but then a debt crisis can have a powerful impact on the order of one's priorities.

A reversal of development

No matter how important the impact of the Third World debt crisis may be on the countries of the North, it is in the South that the real effect, the profound pain, is felt. Many countries have experienced a reversal of their fragile development process as a result of economic crises in which debt has generally played a lead role. Yet some analysts perceived a renewed complacency in the developed countries once western commercial banks had taken effective steps to forestall the collapse in the banking system which they initially feared. But as Cuddington points out, "Even as the vulnerability of commercial banks has declined, the number of developing countries encountering debt servicing problems has grown."

A number of problems accompany the existence of debt service problems and its corollary, net financial outflows. While some countries — Korea, for example — have managed to accelerate exports to avoid or offset the debt problem, others have had little choice but to reduce imports — often to the point of "import strangulation". These and other developments lead to: reduced production because of Third

World reliance on imports for equipment, industrial inputs, fertilizers and the like; reduced investment because of the weakening of the economy; and reduced consumption because of falling real wages and fewer employment opportunities. Often, a vicious circle was created that could not easily be broken.

Morris Miller notes that in this decade average per capita incomes fell by about three percent per year in Sub-Saharan Africa and by about 1.3 percent per year in the highly indebted countries. The cumulative figures for the decade are "25 percent for Africans and 10 percent for Latin Americans." For such countries as Bolivia, Zambia, and even Nigeria and Venezuela, the impact of the crisis on per capita GDP growth may be greater than that suffered by France, Germany or the United States during the Great Depression. The amount of resources devoted to private investment and overall national development in Third World debtor countries declined considerably during the 1970s and 1980s. In the case of the highly indebted countries, the decline was about 40 percent between 1982 and 1985, says Miller. According to figures from the UN Economic Commission for Latin America and the Caribbean (ECLAC), output per capita grew by 32.9 percent between 1970 and 1981 and fell by 3.3 percent between 1982 and 1987.

The impact of the debt crisis on Third World development possibilities is perhaps best summarized in the words of Albert Fishlow. In his critique of John Cuddington's views Fishlow writes, "It is time to understand that the debt crisis has matured into a development problem. African and Latin American countries labouring under their debt burdens are rapidly falling behind." Or, to quote the title of former Jamaican Prime Minister Michael Manley's book, it is like "going up the down escalator".

A natural consequence of these developments is an increase in the gap between North and South. Miller argues: "The income gap between the rich and poor nations has been widening over the span of a quarter century, but the polarization has increased most rapidly since 1980."

This position is, in general, validated by the World Development Report 1991 issued by the World Bank. That report makes two important points. First, it enters an exception with respect to developing countries in Asia. Since the Second World War, some have dramatically closed the real income gap separating them from the industrialized countries and, in the 1980s, this gap began to narrow for the continent as a whole. Secondly, the report notes that the gap between rich and poor countries has narrowed in the case of infant mortality and that of life expectancy. But even these hard-earned gains, which seemed irreversible, are now in jeopardy.

The Human Dimension

Even as some countries bear a heavier toll than others, some within society are clearly more vulnerable than others. The debt crisis has a special meaning for those who live in absolute poverty, unable even to afford a calorie-adequate diet. The World Bank now believes that the number of people regarded as "absolutely poor" could reach a billion this decade and could eventually amount to a quarter of mankind. One-half to three-fourths of the African population subsists in absolute poverty while in Sudan, some 85 percent of the population is said to live at that level.

As governments have had to spend an increasing proportion of their budgets on debt repayments, all other expenditures have been squeezed. While the debate continues as to whether spending for the social sectors has suffered disproportionately, there is little doubt that it has been hard hit.

According to UNICEF, in the 37 poorest countries, health and education expenditures declined by 50 percent and 25 percent respectively in the last decade. When publicly funded health and education services are cut back, those in absolute poverty are unable to pay for private sector alternatives. The aged, the handicapped and the unemployed are examples of those likely to suffer most and earliest. Women constitute another vulnerable group, both in their own right and in their role protecting their children from social dislocation. According to the UN, women work harder in and outside the home, earn less, suffer physically and emotionally as a result and see their life chances and those of their children further diminished by the present crisis. The publication adds, "If nothing is done to compensate for the blows to their standard of living, the economic policies adopted to deal with the crisis often have very negative side effects on the poorest and most vulnerable people in society, especially women."

The extent to which these human problems can be blamed directly on the debt crisis is debatable. They are obviously the outcome of a mix of factors including drought, wars, inappropriate policies and the overall challenges posed by underdevelopment. However, their impact appears to be compounded, even if not caused, by the debt crisis.

One of the most telling pieces of evidence that the development process is in trouble in much of the Third World is the fact that progress in reducing infant mortality rates has stagnated after a number of encouraging decades. Indeed, in some debt-distressed countries, infant mortality has increased. This reflects both reduced expenditures on health and, perhaps more importantly, reduced access to adequate nutrition due to falling incomes.

Declining social programs

Similar reductions in education spending are affecting the world's children in a different but quite profound manner. In the case of Sudan, UNICEF writes, "A whole generation of children has now bypassed the educational system, providing a further impediment to future economic growth. Malnutrition has been endemic and widespread for years." Of course, Sudan has been not only debt-ridden, but also war-torn. But the phenomenon extends far beyond the Sudanese border. In 1990, Stephany Griffith-Jones and Rolph Van Der Hoeven wrote, "With such a squeeze and contraction of the economy, it becomes difficult and often impossible for even a well-meaning government to safeguard, let alone expand, its social programmes for children. In many debt-distressed developing economies, public per capita expenditure on education and health either in absolute real numbers or as a percentage of GDP is declining. Such reductions in countries with a relatively low level of social expenditures, even if governments are capable of spending their money more efficiently, will necessarily reduce the value of a country's human capital and hamper growth."

The 1990 Session of the UNICEF Executive Board was told by many delegations that difficult economic circumstances combined with the debt burden were making it impossible for many of their countries to maintain adequate levels of social programs particularly those beneficial to children. According to UNICEF Deputy Executive Director (Programmes) Richard Jolly, "not only are the human issues of great humanitarian importance, but they are also of fundamental economic importance, especially if economic growth is to be restored. Many studies of the sources of economic growth, in both industrialized and developing countries, have shown that to achieve economic growth, human capital is of greater quantitative significance than physical capital."

Children are the victims

The ultimate injustice, though, is that after constraints of health, education and economic development are placed upon the new generation, that same generation is then charged with the burden of repaying the debt. Referring in 1985 to the $1.8 trillion US national debt, evangelist and inspirational writer Robert H. Schuller and his co-writer, Paul David Dunn, said, "It is not fair, but the sad truth is that all children born in the USA today are met with a burden they cannot begin to shoulder, a burden they did not ask to bear. ... When we, the current generation of Americans, spend money that we expect the next generation to pay back or to pay interest on, we are stealing from the disposable income of our children." The situation facing Third World peoples is made even worse by the fact that, unlike in the USA, most of the debt is owed to external creditors and not to themselves. At least some economists would argue that leaving future American generations a legacy of debt may be preferable to bequeathing to them a poor

economy and low standards of physical and social infrastructure. In the case of Third World children, not only is their disposable income stolen in advance, but also, because of indequate health, educational and economic opportunites, there may be little disposable income in the first place.

Perhaps, there is a spark of hope in the words of the World Declaration on the Survival, Protection and Development of Children adopted by Heads of State and Government at the September 1990 World Summit for Children. The leaders acknowledged that "each day, millions of children ... suffer from the grave effects of the problems of external indebtedness...." They solemmly declared: "For the sake of the future of all children, it is urgently necessary to ... give urgent attention to an early, broad and durable solution to the external debt problems facing developing debtor countries." They pledged, "We will work for a global attack on poverty, which will have immediate benefits for all children's welfare ... that calls for transfers of appropriate additional resources to developing countries, as well as improved terms of trade, further trade liberalization and measures for debt relief." Will these noble words be translated into tangible deeds?

Northern

Evolution and Convergence

Between 1982 and 1990, 435 books and 2,940 articles and working papers on the subject of external debt were added to the IMF-World Bank Joint Library. Despite this volume of literature and the fact that the debt crisis has spawned a rich harvest of proposals and initiatives numbering in the hundreds, the world is still far away from a final solution to the crisis. However, there is growing evidence of a convergence of views with respect to both the seriousness of the problem and the kinds of action needed to address it.

The UN General Assembly in 1990 approved a consensus resolution on Third World debt. The resolution called for immediate action to find a "durable, equitable and mutually agreed growth and development-oriented solution," and called for initiatives to be strengthened and broadened to include all categories of debt and debtor countries, especially the least developed countries. There is also evidence that some countries have begun to see the light at the end of the tunnel.

For a long time, there have been mechanisms for addressing problems connected with debt. One of these is the Paris Club which negotiates terms for rescheduling payments on loans issued or guaranteed by creditor governments. Another is the London Club which performs a similar function in relation to credit given by a commercial bank without its own government's guarantee, but with the guarantee of the government of the debtor country. Traditionally, such standing arrangements, as well as earlier initiatives to deal with the crisis, have not altered the overall obligations outstanding. They have tended to focus on the need for creditors to be paid and for debtor nations to adjust their expectations, their consumption patterns and their financial management. Increasingly, however, such concepts as debt reduction and even debt forgiveness are finding a place in the agreed lexicon. Intellectually, the US approach can be said to have come almost full circle from acquiescence to increased commercial lending in the 1970s to insistence on adjustment in the 1980s to a shared responsibility based on both adjustment and debt reduction as well as new financial flows in the 1990s.

A number of reasons have been given for the gradual shift in attitudes which, it might be noted, has been the consequence of policy change more in the North than in the South. One of the more dramatic events leading to the change, particularly with respect to the official US position, appears to have been the 1989 riots in Venezuela. Western bankers and statesmen seem to concur with President Carlos

The Peruvian And Costa Rican Approaches Compared

The Peruvian and Costa Rican approaches to default on debt payment offer an interesting contrast. However, there are also some interesting similarities. For example, both countries tried default as a strategy to resolve the dilemma between meeting debt payments and finding resources for development. Both relented in the face of powerful international pressures. In each case, a change in government triggered the change in policy.

Peru

In August, 1985, Peruvian president Alan Garcia instituted a policy of limiting the percentage of export earnings to be applied to debt servicing. The initial figure, he declared, would be 10 percent. His announcement was accompanied by radical remarks questioning the role of the International Monetary Fund and was followed some time later by the termination of negotiations with the international creditor banks.

Garcia's policy was, in part, a response to the economic disruption and human suffering seen to be resulting from adjustment policies. In those pre-Brady times, adjustment was virtually the sole mechanism used for repairing sick Third World economies and squeezing resources for external debt payments. UNCTAD debt adviser Oscar Ugarteche noted that between 1975 and 1984 the share of the Peruvian national income paid as reward for work had fallen from 73.5 percent to 58.7 percent. Conversely, the share of profits in the national income had risen from 26.3 percent to 41.3 percent during the same period. At the time of the announcement, infant mortality was 92.7 per thousand (about 8 in Canada) and the percentage of children under six who were malnourished stood at 44.

Not surprisingly, therefore, Garcia's policy, radical as it was, won some sympathy even in the West. Canada's Globe and Mail declared: "The decision of the new President of Peru to flout the IMF is not the act of an angry young man. How does an impoverished nation with a crumbling economy justify interest payments to foreign bankers while its own people decline into misery and social chaos?"

However, there was opposition where it most hurt. Morris Miller points out in his UNDP discussion paper that the message such as that contained in the Globe and Mail article "did not ... find an echo among the creditor community." The members of that Community argued, in part that "the policy was too rigid and unworkable given the difficulties of determining the 'acceptable' ratio of export earnings to debt servicing." Miller adds, "... Peru is paying a high price for this unilateral declaration of defiance. The self-fulfilling forecast has been taking its toll. It is therefore hardly surprising that few other countries have dared as yet to follow through with this type of unilateral action."

All of this is not to suggest that international pressure in response to Peru's confrontation was the sole cause of the country's subsequent problems. The then government's approach to macro-economic management has also been blamed for the country's economic — and the government's political — fortunes.

In any event, the Fujimori Government, which came to power in July 1990 was soon busily engaged in the dismantling of the previous policy of defiance. The Government has assured the international community that it is "committed to modernize the economy, restore its economic balance to achieve sustained growth and end Peru's isolation from the financial community."

Costa Rica

It is important to note at this stage that Garcia did not, so to speak, write the book on debt default. Since independence, Peru has gone through four cycles of contracting debt, defaulting on payments and being denied access to further foreign credit. Moreover, in relation to the contemporary situation, Costa Rica had declared a debt moratorium four years before Peru did.

Costa Rica, like Peru, has gone through the two phases of withdrawal from and return to the accepted norms for debt servicing. There are at least two differences, however. There is a historic difference in that Costa Rica has completed its return to "normal behaviour" and begun to reap the rewards. Also, there is a geopolitical difference in that Costa Rica has been able to parlay its strategic advantages into relative success in the resolution of its debt problems and in dealing with the attendant economic challenges.

Costa Rica declared its unilateral moratorium in August, 1981. As with Peru in 1985, this act of economic defiance was matched by political defiance. Costa Rica's support, at that time, for the Sandinista government in Nicaragua served, in the words of Ennio Rodriguez, to "[further restrict] Costa Rica's room for manoeuvre". Rodriguez summarizes the Western response thus: "External finance dwindled to practically nothing and lawsuits began to be filed in the courts of the United States."

The change in government in May the following year led to an abandonment of the confrontational strategy. At the level of economic policy, the new government commenced negotiations with the international banks. At the political level, it opted for a policy of neutrality towards the Sandinista government and one of friendship towards Washington. These changes soon began to pay dividends. According to Rodriguez, "The strategy of following the rules of good behaviour in order to have access to fresh funds has been successful."

Three other points should be noted. The first is that neither Costa Rica's political acumen nor its economic approach was enough to cause it to be spared the rigours of adjustment. The second is that much of the positive foreign exchange inflows experienced by the country was the result of funds provided by the United States Agency for International Development (USAID) — some $1.6 billion between 1985 and 1989.

The third is that after Costa Rica's return to "good behaviour", it was known to withhold interest payments. But it always did so in an unspectacular, unheralded manner. According to Roy Culpeper (Growth and Adjustment in Smaller Highly Indebted Countries), "The secret was avoiding confrontation with creditors, along the lines of Alan Garcia's 1985 announcement that Peru would limit debt-servicing." He adds: "Costa Rica's negotiations with the banks never stopped, even while interest payments were being withheld." History might well decide that one of Garcia's fatal errors was to allow such negotiations to lapse.

The culmination of Costa Rica's success in exercising its economic management, political strategy and negotiating capacity was the package it obtained under the Brady Plan. Through that deal, the country reduced its debt service by two-thirds. This amounted to a legitimization, by the banks themselves, of the quiet politics of non-payment pursued by the Government over the past few years.

Andres Perez's assertion of 4 March 1989 that, "the crisis [we] are undergoing has a name written in capital letters — FOREIGN DEBT."

The shift in perception in the industrialized North relates not only to the fear of political instability, but also to what Stephany Griffith-Jones calls "the excessive human cost of the adjustment of developing economies to the debt problem and to the deteriorating international environment". Griffith-Jones notes that this perception is shared by international organizations, the media and the wider public.

Radical alternatives

Few countries have acted on the thesis put forward by Cuban President Fidel Castro that "the debt is unpayable and should not be paid." Although a number of countries including Brazil and Nigeria found it necessary to suspend payments on their debts temporarily, Peru was almost alone in adopting the confrontational fanfare consistent with the Castro position. In 1985, Peru announced it would limit debt payments to 10 percent of export earnings so as not to close off avenues for national development and social welfare. But, in fact, Costa Rica has successfully recorded growth by pursuing a low-key strategy of unannounced unilateral debt moratorium. (See page 23 for an explanation of the Costa Rican situation.)

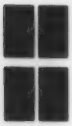
Griffith-Jones examines the reason why other governments have been so much more patient than Peru in this regard. Not only have they avoided setting limits to their debt payments, but they have been almost deferential in their negotiating strategies. At least three possible reasons could be easily identified. The first is the fear of reprisals. These could take the form of refusals to grant new loans or ODA flows to offending debtor nations or the imposition of punitive tariff barriers of the type contributing to the crisis of the 1930s. But there is also the sanction of seizure of national assets which has been provided for in the laws of some creditor nations since the 1970s.

A second possible reason — in a sense the other side of the coin — was the need to preserve creditworthiness. There was always the hope that the overall direction of financial flows would again shift southwards, as in earlier decades. This hope looked remote in 1985 when the reverse flow extant since 1983 had just about wiped out the net gains resulting from the continuous flow of petro dollars in earlier years. But recent changes suggest that the years of patience may not have been totally in vain.

Griffith-Jones posits another explanation, one that relates to the dynamics of domestic politics in some Latin American countries in particular. She argues that a small but rich segment of society, concerned with protecting its overseas financial interests, used its influence to discourage Latin American governments from doing anything that could

have repercussions for its savings and investments in industrialized countries.

Taking a stand



These considerations might have accounted for governmental refusal to articulate a radical debt negotiation strategy. However, as they became less important, Latin American governments moved towards a somewhat tougher negotiating stance. Griffith-Jones points, for example, to the role played by the shift towards democratic forms of governance and the increasing assertion and importance of popular resentment against adjustment measures. These tended to cause a reversal of the previous situation where the financial interests of the rich few, rather than the survival and developmental needs of the majority, influenced the style and strategy of debtor country bargaining.

According to Griffith-Jones, the more impatient Peruvian approach is explained by the fact that, "since mid-1985, the Garcia Government has faced not only a difficult economic situation, but also a very tense political situation, with an extremely serious challenge to its stability (and that of democracy in Peru) coming from the extremist Sendero Luminoso guerrillas and a country that lacked a sense of future and of national unity." Griffith-Jones adds: "President Garcia's unilateral action on debt, as well as the particularly uncompromising harshness of his language towards foreign creditors and the international financial institutions, can thus be explained to an important extent by the 'need' to find an 'external enemy' which provides a catalyst for national unity."

Moderate alternatives

In Brazil's case, Griffith-Jones suggests, the temporary suspension of debt service took place only after a perception that paying the debt conflicted with the country's aspirations with respect to national growth. Mexico's greater reluctance to take a strong position responds, says Griffith-Jones, to its belief in the importance of harmonious relations especially with its rich and powerful neighbour to the North.

Whatever the reason for most debtor governments taking a careful low-key negotiating stance, some analysts believe that that has led to a situation where bankers practised what might be called debt write-off without debt forgiveness. In other words, the value of a $100-million sovereign Third World debt, for example, might be changed in the banks's books to reflect the value in the discounted open market — say, $20 million — so the bank could obtain the tax and other benefits of doing so. However, the bank would still press for a full $100-million repayment.

This practice of debt write-off without debt forgiveness has been reflected in the development of initiatives and proposals which respond

to creditor rather than debtor needs. In the words of Eugene H. Rotberg, a senior exective Vice-President of Merrill Lynch and Co. and a former World Bank Treasurer, "the terms 'debt relief' and 'debt reduction' describe the effect on the creditor's books after a transaction is executed. They are not the before and after actual cash burdens on the poor."

Baker Plan

One of the better known among the hundreds of debt initiatives, the Baker Plan, was announced by then US Secretary of State James Baker, III at a joint meeting of the World Bank and the International Monetary Fund in Korea in October, 1985. One of the most significant things about the announcement was that it represented the first official recognition by the US Government that the problem was too big and too complex to be resolved by the mere demand for austerity and compliance on the part of debtor nations. The Baker Plan recognized that infusions of new money were required. Baker proposed an increase during the ensuing three years of $29 billion in lending to selected debtor countries — $20 billion to be provided by commercial banks and $9 billion mainly by the World Bank and the Inter-American Development Bank. The plan also envisaged a greater World Bank role in the provision of long-term funding to supplement the IMF's short-term lending, and firm international supervision to ensure the new funds were used to stimulate long-term economic growth. Accelerated privatization and reduced capital flight were among the conditions to be extracted in exchange for the provision of new capital.

In general, the Baker Plan did not represent an abandonment of the concept that the debtors had the principal responsibility for putting their houses in order so they could be in a position to liquidate their indebtedness. However, when Treasury Secretary James Baker announced the Plan in 1985, he had at least signalled US recognition that the debt crisis was no passing problem, that the world was in it for the long haul. The Plan was based on the presumption that debtor countries could grow their way out of debt — if they would only adopt market-oriented structural reforms and if western banks could be enticed by the reforms to provide some new loans. This policy was directed principally at the highly indebted middle-income countries.

The failure of the Plan is generally accepted with a number of reasons put forward to explain this failure. The lack of any specific commitment or clout on the part of the US Government beyond moral suasion left both western banks and developed-country governments fairly unimpressed. Both commercial banks and multilateral development banks failed to provide the new funds which were a sine qua non for the success of the Plan. Even where agreement was reached, the lack of cohesion among the banks ensured that this came only after a painfully slow negotiating process.

Some Other Initiatives

While only a few debt reduction initiatives — such as the Baker and the Brady Plans — might have instant recognition with John Q. Public, there have in fact been hundreds of initiatives and proposals purporting to provide solutions to the Third World debt crisis. There are so many proposals that several compilations have already been done. Morris Miller, in his UNDP policy discussion paper Resolving the Global Debt Crisis, lists 14 such compilations. He also summarizes more than 80 of the proposals. Few of the proposals can claim to be flawless. Few have been fully tested.

The proposals have come from various sources — communist leaders like Fidel Castro and Mikhail Gorbachev, western leaders and western summits, academics, journalists, banks and bankers, non–governmental organizations, the United Nations and its specialized agencies and a number of Third World leaders.

Miller sugests that most of the proposals are what may be called "enhanced muddling through on a case-by-case basis." The proposals by French President Francois Mitterand and U.S. Senator Bill Bradley were among the few proposing "across-the-board measures," he said, and even these needed to have their details elaborated on a case-by-case basis.

"Only a few proponents," said Miller, "... seek to go beyond the status quo ante and address the issue of what needs to be done by way of structural adjustment of the global system that gave rise to the debt crisis in the first place." He included in this category proposals in a Commission report published by the Commonwealth Secretariat as well as those by Dragoslav Avramovic, Sidney Dell, Martine Guergil and Lord Harold Lever respectively.

Among the U.N. proposals are those by the Secretary-General calling on creditor countries to convert all bilateral aid loans into grants and to reschedule all official trade debts at the rates applied to loans issued by the IDA, the World Bank's soft loan window.

The announced Brazilian debt moratorium of early 1987 is generally accepted as that country's repudiation of the Plan. Still, almost two years later, the Plan remained the flagship of creditor countries' debt strategy. In the words of the UN, "Other proposals were brushed aside, while 'debt forgiveness', even of a limited scope, was considered beyond the bounds of serious discussion." Evaluating the Plan's assumption that countries could grow out of debt, the Standing Committee report declares: "On the contrary, low international demand for their exports, including protectionist obstacles to exports of manufactured products, as well as reduced flows of direct investment and stagnant foreign aid was responsible for a slow or, in several cases, a negative rate of economic growth."

Brady Plan

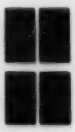
Despite the obvious limitations of the initiative announced March 1989 by US Secretary to the Treasury Nicholas Brady, the world crossed a major psychological barrier with the Plan through which, for

the first time, the US formally accepted the idea of debt reduction. Trying to cast the so-called Brady Plan in the double light of orthodoxy and dynamism, David Mulford, Assistant Secretary to the Treasury declared that, "it built on the 'fundamental principles' of the current strategy for addressing debt problems." These, he said, included stronger growth in debtor nations; debtor reforms to achieve that growth; external financial support; and the case-by-case approach.

Other elements of the Plan include waivers, for up to three years, of the provision that debtor banks would share the risk on the basis of how much of the debt is owed to them. This was intended to provide greater flexibility in implementing other aspects of the Plan. Yet another element was the withdrawal of US opposition to increasing IMF quotas and other ways of increasing IMF resources so the Fund could assist debt-distressed countries together with parallel Japanese financing. The Plan also provides for special IMF and World Bank facilities to fund debt reduction arrangements and for support for modalities to permit the commercial banks to conduct debt reduction negotiations singly rather than only on a collegial basis.

There are clearly some elements of the Plan which represent an important departure from the past. The magic words leaving Secretary Brady's lips signalled that "we should encourage debt and debt service reduction on a voluntary basis, while recognizing the importance of continued new lending." Apart from the receiving of the debt reduction idea into US policy, one of the differences with the Baker Plan was the apparent reversal of the cause-and-effect relationship between economic growth and debt reduction. Baker thought countries could grow out of debt — an objective which leading economist John Williamson believed "risks pushing resolution of the debt crisis forward into the next century." Brady, on the other hand, posits debt reduction as a facilitator of such growth.

Evaluating the Brady Plan



Assessments of the Plan have been wide-ranging. A team of officials from Moody's Investor Services described it as an updated version of the Baker Plan. On the other hand, Griffith-Jones, while noting that the Plan leaves many questions unanswered, asserts that it "includes a number of innovative elements" and is "an important opening towards a favourable outcome." Roy Culpeper points to a number of difficulties both in the conception and in the implementation of the Plan and concludes that it "might be too little, too late."

Even among those who accept that the differences between the Baker and Brady approaches are more than cosmetic, many point to a number of weaknesses and limitations. These include the fact that the amount of resources identified for underpinning the debt reduction objective is not enough to make a major difference. Another is that the role identified for the World Bank and the IMF effectively puts them in the position of taking over the debt while letting the commercial banks

off the hook. This seems to support the thesis expounded by Robert Devlin when he noted in CEPAL Review (the ECLAC periodical) in 1984 that, "an economic system based on private market [decision-making] tends to privatize profits and socialize losses." And Jeremy Bulow and Kenneth Rogoff believe that a substantial part of the funds provided to buy back the discounted debt will end up in private hands. Moreover, like Culpeper, they feel that funds from bodies like the IMF and the World Bank should be invested in the development of deserving Third World cases rather than being spent in support of large debtor nations and ending up in the pocket book of developed-country bankers.

Culpeper points to three other specific weaknesses in the Brady proposals. First, he feels that the new, additional flows required from the commercial banking sector were unlikely to materialize — a belief apparently supported by the way many banks in the West, including those in Canada, have "voted" on the proposals "with their balance sheets" by enhancing their loan loss provisions instead of availing themselves of the relief options proposed by the Plan. Secondly, he feels that any effective debt strategy must address the high prevailing interest rate levels. Thirdly, he argues that the World Bank and the IMF need to have their capability enhanced "not to backstop old debt but to invest in new real capital to get these economies growing again."

The Toronto terms

The G-7 Summit in Toronto in 1988, proceeding largely on the basis of French and British proposals, agreed to the "Toronto Terms". These provided for western governments to choose from a menu of three options in helping to bring relief to the debt-distressed African countries. The options were: forgiving one-third of the debt; reducing the interest by one-third; and extending the rescheduling period from 14 to 25 years. The latter option was included in view of the prevailing US orthodoxy which in those pre-Brady days emanated from an aversion to anything with a hint of debt reduction. Oxfam UK and the European Debt Network note that after its first full year of operation the Toronto terms helped save African nations $50 million — "less than was provided to Africa by Oxfam and Save the Children Fund, the two largest development NGOs in the United Kingdom".

At least two reasons are being offered in explanation. One is the fact that the terms apply not to a country's entire stock of debt, but only to those being considered for Paris Club rescheduling in the current year. The other is the weakening of the menu to satisfy the US position by adding the third option, a lengthened rescheduling period. The organizations note that since the countries are, in any case, not in a position to service the loans, the difference between a 14-year and a 25-year rescheduling is essentially meaningless.

The Trinidad Terms

The British Government has submitted new proposals, called the Trinidad Terms, so named because they were first proposed at a Commonwealth Finance Ministers Meeting in Trinidad and Tobago. These seek to strengthen the Toronto Terms in a number of ways. The British proposals include: treatment of a country's entire debt stock in a single long-term arrangement rather than on an annual basis; doubling the debt relief from one-third to two-thirds; combining the three "Toronto" options, in effect, into a three-course meal instead of retaining them as separate optional items on a menu; the institution of a five-year "interest holiday"; widening of the scope to include very poor debt-distressed countries outside Africa; and a comparable response to the plight of debt-distressed countries by commercial banks.

A number of countries in Sub-Saharan Africa have benefited from the implementation of this scheme and some analysts believe that, even in its present form, it is capable of being more fully utilized. The feeling remains, however, that more needs to be done if such countries as Mozambique, Somalia and Sudan are to be saved from endless distress.

Canada's response

The report of the Canadian House of Commons Standing Committee on External Affairs and International Trade (SCEAIT) on the debt crisis, although not putting forward a major new initiative, suggests ways in which Canada can help make a difference. The Committee recommended, inter alia, the achievement of equitable burden-sharing among all parties to the debt crisis; reversal of the capital flow from a South-North to a North-South direction and orienting debt service in terms of the capacity to pay; rethinking the orthodoxies of economic adjustment to give priority to sustainable human development; and asserting a strong Canadian participation in international efforts to resolve the crisis. The Committee saw this Canadian role as encompassing, among other things, the use of Canada's position to advocate major changes in the way international financial institutions respond to the crisis, and a call to Canada to "seek the support of other governments for an international conference on debt and sustainable global adjustment, such a conference to aim for negotiated commitments to policy reforms by all countries, not only the poor and indebted."

The report advocates the establishment of a standing, high level, multi-sectoral task force on international debt and adjustment to "review and update Canadian initiatives on the North-South agenda." The task force — to include representatives from government, business, the NGO and academic communities, and the Third World — would report annually to the Standing Committee. SCEAIT says its recommendations arise from its concern that "out of the global crisis of debt and lost development must come not only debt reduction today, but also a renewed agenda of North-South reform."

The Standing Committee accepted a proposal submitted by Roy Culpeper of the North-South Institute which encouraged banks to go beyond making provisions in case of Third World loan default. The idea was to reward banks which actually wrote down such loans. The authors of the proposal contended that Third World debtors — and such countries as Canada which traded with them — would benefit from the actual reduction of the "debt stock". In this context, the proposal, adopted by the Committee as part of its recommendations, would give banks tax credits for loan loss reserves beyond the present limit of 45 percent of their Third World debt portfolios. However, loans would only qualify for the additional tax credit if actually written down or sold to agencies committed to writing them down. The proposal would also limit the extent to which banks could hold loan-loss reserves for more than five years without writing down the loans covered by those reserves.

The Standing Committee's report was published in June, 1990. In November of that year, then Secretary of State for External Affairs Joe Clark presented the Government's response. For the most part, that response constituted neither an acceptance nor an outright rejection of the Committee's recommendation. It was more a statement that the Government was already pursuing, in its own way, a national and global strategy to help solve the crisis.

After all these ideas, options and initiatives, how close is the Third World to a final resolution of its debt crisis? Has the West learned anything from the experience? In the pages which follow, possible answers to these questions will be examined.

The unwanted legacy of mankind

So the Third World debt crisis may not be so Third World after all. Indeed the crisis is shaping up to be one of those scourges originally perceived to be relevant only to the other half of the world, but proving in the end to be a blot on mankind's collective conscience, a part of the universal reality, the chime on the bell that tolls for everyone. In the words of the Standing Committee report, "Because debt is not a one-way street, we must resist the myth that the Third World's debt crisis is only their problem and not also ours."

Viewed through the prism of newspaper headlines, the debt crisis has all the makings of a North-South confrontation. Understood in terms of the imperatives of survival in the global village, the crisis is a challenge for cooperation.

Creating a harmonious marriage from what might initially be perceived as contradictory circumstances is not easily done. But it is happening in universal child immunization (which wars halted temporarily in Latin America and the Middle East) and, generally, in child welfare and child development. It is beginning to happen in arms control. It is about to happen, hopefully, in the environmental field. Perhaps it can be made to happen in the resolution of the debt crisis.

The secret, no doubt, is to become conscious of the potential of the crisis to exercise a negative impact both on the lives of people in the poor South and on those of citizens of the industrialized North. Already, as is noted by Albert Fishlow, professor at the University of California at Berkeley, the problem has matured into a developmental one. Its links to the environmental crisis may be indirect, but they are undeniable. Whether the crisis is viewed in terms of self-interest or as a moral issue, it constitutes a quintessentially global concern.

Miller has put forward three sets of prerequisites for a solution to the crisis. The first is an annual growth rate of at least four percent in the major industrialized countries and a commitment not to increase, but if possible to diminish, the trade barriers to "Third World exportables". Another is the recovery of commodity prices, a concommitant improvement in the terms of trade of developing countries and a reduction in real interest rates (i.e. allowing for the rate of inflation) to the historic range of one to two percent. And the third is "a significant increase in the flow of new funds to the debtor countries that would not only reverse the present direction of the flow but go much beyond this to attain a level commensurate with meeting their 'minimum' needs for

recovery of lost ground and for improvement in living standards." If these criteria constitute the appropriate way to respond to the problem, they remind us of the need for mankind as a whole to see the nexus between debt and such other factors as trade, human survival and development, and productive and harmonious interaction with the environment.

The actors

The playing out of the debt challenge requires a cast of many actors. There are the traditional, most obvious ones. Developing-country leaders must match their call for international flexibility with the capacity to improve their national policies and mobilize appropriate popular action and support. They need to articulate the national interests at the bargaining table. Where appropriate, they must provide an example even to the international financial community through measures to repatriate capital which has flown the wrong way — into western-held bank accounts. Developed-country governments should make efforts to improve the developmental climate by increasing ODA flows, liberalizing arrangements for Third World exports and taking steps to improve the terms of trade. They should also reorder their tax legislation and policy measures in such a way as to end the banks' practice of writing off debt without forgiving it.

Banks must of course continue to protect their right to be paid. They should also be aware, however, of a point made in 1991 by Uwe Holz, a German academic and parliamentarian, and Jan Tinbergen, winner of the 1969 Nobel Memorial Prize in Economic Science. The two noted that after paying $673 billion between 1983 and 1990 on a $644 billion debt, Third World countries still owed $950 billion. This is a kind of arithmetic facilitated by the departure from historic interest levels to an extent that has caused many western statesmen and scholars to balk. "Much of the build-up in debt payments is because of unilateral hikes in international interest rates which reached historically abnormal levels during the 1980s," said the House of Commons Standing Committee on External Affairs and International Trade. "How can such an unjust, unhealthy situation be allowed to continue?"

Who is responsible?

More fundamentally, however, the banks should accept part of the blame for inappropriate and imprudent loan approvals in the first place. This would imply, in turn, sharing both the responsibility for solving the problem and the pain involved in so doing. International financial institutions have a role to play not only as significant holders of Third World debt but as beneficiaries of the negative net capital flows suffered by the developing world. As many analysts have been pointing out, they need to combine a demand for appropriate policy changes in

debtor countries with steps to stop the trend towards "negative investments" in these countries.

But another actor in the denouement to this drama is the community of non-governmental organizations (NGOs) active in this and related fields. Among the remarkable institutional developments of our times is the process by which international NGOs have become builders of intercontinental bridges and guardians of the global conscience. The aid-giving role of the NGO persists, of course. As noted above, financial flows from only two NGOs challenged for a while the benefits of a major debt initiative, authored by the heads of the seven leading economic powers. While continuing and perhaps expanding their role in the mobilization of financial resources, NGOs might be expected to enlarge their activities in the area of advocacy and in the promotion of meaningful international dialogue. They can serve as interpreters in getting the North and the South to understand each other's reality and as facilitators in bringing the two sides, literally and figuratively, to the same table to seek ways to resolve their common challenge.

Turning a corner in the crisis?

Having raged through the 1980s, will the Third World debt crisis also outlast the 1990s? Encouraging signs are beginning to appear, but the prospects remain mixed and uncertain.

Some Latin American countries are beginning to show signs of improvement through the combination of a more supportive international environment and more effective domestic action. However, even in those countries the crisis is far from over. And even these rays of hope are absent from the economic horizons of Sub-Saharan Africa. Brazil's Minister of Economy, Finance and Planning Marcilio Marques Moreira says, "Overcoming the debt overhang remains an elusive goal for far too many debtor countries."

From the perspective of the Western commercial banking sector, however, the crisis seems much nearer to a definitive end. Brian O'Reilly says that "sovereign debt has stabilized." He declares that while the total debt is double the figure of 10 years ago, it has not changed much in the past three years. The World Bank, in its most recent review of developing country debt, notes that the static nature of the total debt figure masks a steep increase in the obligations of the world's poorest countries. The report declares: "The debt burdens of a large number of the poorer countries remain unsustainably high."

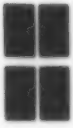
According to O'Reilly, the 15 debtor countries causing the banks the most trouble "were obliged to pay out a stiff 22 percent of their export revenue in 1990. Anything over 20 percent is considered a serious burden. But that is still well below the 30 to 35 percent they owed during much of the 1980s." He added that "few of the large regional or medium-sized [banks] hold much LDC [least-developed country] debt anymore, but earnings of four of America's money centre banks remain

vulnerable to default by one or two large overseas borrowers." (The term "money centre banks" refer to a group of about half a dozen very large US banks, based mainly in New York, which operate as a kind of bankers' bank. They would, for example, group a number of regional banks into syndicates to put together large international loans). In the case of Canada, only two of the "big six" banks have much "LDC exposure".

While there is little if any reduction in the overall debt figures for Latin America, there are at least four positive signs. One is the beginning signs of an upturn in some of the national economies. A second and consequent sign is the growing perception that many of the countries are, or will be, in a position to meet their external debt commitments.

A third is the fact that some countries are beginning to attract new financial flows from abroad. Brian O'Neill, general manager of Chase Manhattan Bank in Sao Paulo, Brazil, is quoted in a recent article in the Globe and Mail as saying: "As opposed to a couple of years ago, when good deals couldn't get financing, today they can be done." Fourthly, newly negotiated arrangements have produced more bearable repayment terms than hitherto.

Resurfacing

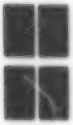


Mexico — which, in a sense, gave birth to the Third World debt crisis — seems, appropriately, to be leading the recovery as well, with signs of recuperation on all four fronts. After recording zero GDP growth and a 50 percent decrease in the purchasing power of earnings during much of the 1980s, the economy grew at an annual average of three percent during the years 1989 and 1990 and was expected to grow by five percent in 1991. David Asman declares: "Even the sternest critic of Mexico can no longer deny the success of President Carlos Salinas' macro-economic policies." Mexico is routinely listed these days as one of the countries capable of paying their debts. This perception and confidence in the country's capacity to attract foreign capital flows are evident, for example, from Brian O'Reilly's report that "some new Mexican government bonds won Ba2 safety ratings from Moody's — higher than Chrysler bonds." According to Asman, Mexico received "a record $4.4 billion" in direct foreign investment in 1990. There are reports of possible shifts of manufacturing enterprises from Asia to Mexico as investors seek to take advantage of the North American Free Trade Agreement (NAFTA) expected to be signed by Canada, Mexico and the United States.

According to a senior Mexican Government official, repayment terms, the inflow of new capital and the size of the debt stock have all become more favourable as a result of negotiations held within the framework of the Brady Plan. The official said the total debt stock had been reduced from $107 billion to $90 billion and that this reduction plus the lower interest rates has lowered the debt service from six

percent to two percent of GDP. At the same time, reduced public sector spending as a result of privatization policies has led to a balanced budget, the reduction of the internal debt by half and the Government's first budgetary surplus in recent history.

Mexico's policies



The official explanation for Mexico's turnaround is two-fold: President Salinas' economic policies and the implementation of the Brady Plan. The main elements of the policy have been deregulation and increased privatization, export promotion and trade liberalization. The greater opening up of the economy and the aggressive pursuit of export opportunities have been likened to the post-war Japanese approach.

Some analysts point to a number of unhappy features about the Mexican situation, however. One is that the greater portion of the debt remains; the risk has merely been shifted from the private commercial banks to such multilateral financial institutions as the World Bank and the Inter-American Development Bank. There is also some debate about the extent to which the Brady Plan has been instrumental. One observer has pointed out, for example, that Chile, although not a beneficiary under the Plan, is proving to be one of the success stories of Latin America.

Success stories

Chile's name in fact appears in many of the reports on the recovery of Latin American debtor nations. "A good Mexican, Chilean or Venezuelan project is financeable today," says O'Neill in the Globe and Mail article. And Brian O'Reilly declares in his Fortune article: "Mexico and Chile, helplessly mired in debt a few years ago, have reformed their economies so thoroughly that they were able to borrow new money from capital markets last year on favourable terms." O'Reilly says that since 1985 Chile has been able to cut its bank debt by 40 percent to $9 billion, partly by "letting creditors swap their debt for equity interests in business."

Costa Rica and Venezuela, on the other hand, are examples of countries which, like Mexico, have benefited from the Brady Plan. Both are now listed among those receiving new, increased capital flows. Bolivia has also begun to receive such flows. Costa Rica, Uruguay, and Venezuela — as well as Chile and Mexico, of course — are conspicuous examples of countries benefiting from more aggressive, outward-looking, export-oriented economic policies.

Argentina, Brazil and Peru have been less successful in resolving their debt problems. These three have had varying measures of success in raising funds on the international money market. Despite a series of shock treatments aimed at controlling inflation and promoting growth,

IDRC And The Search For A Solution

Debt Bargaining

IDRC has supported two research projects under the leadership of Chilean social scientist Stephany Griffith-Jones, now a Reader at the Institute of Development Studies, University of Sussex in England, and Ennio Rodriguez, former Costa Rican Minister for Debt and Foreign Finance.

The first involved a study of the strategies employed in debt negotiation by individual countries and groups of countries in Africa and Latin America. The project started with a series of research papers and included two conferences on the subject in Brighton, England and in Mexico City. These conferences brought together a wealth of social science talent and banking, diplomatic and governmental experience. It culminated in the publication of Stephany Griffith-Jones, ed. Managing World Debt, Hertfordshire, England (Harvester-Wheatsheaf) and New York (St Martin's Press), 1988. This publication not only records the debt negotiation and debt management experiences of the countries studied; it also provides valuable insights and ideas on possible improvements to these processes.

In a second phase, the focus shifted to the role of developed-country banks in efforts to resolve the crisis. Specifically, it involves a series of studies on "cross-conditionality, banking regulations and the Third World debt." Once again, though, the questions were addressed in terms of the experiences of individual countries. Among the issues dealt with by the researchers was the particular importance of reviewing Western banking regulations in view of the centrality of the concept of debt reduction to the Brady Plan. Griffith-Jones, for example, discusses this question in one of two papers she has done for this project, entitled "European Banking Regulations and Third World Debt: The Technical, Political and Institutional Issues." Like the North-South Institute's submission to the Standing Committee, this paper examines the need for banking and tax regulations to encourage banks to write down Third World debt and not just reserve funds against the possibility of an eventual default.

the Brazilian government approached the end of 1991 without being able to put its economic house in order. Negotiations with its commercial creditors led to agreement on the rescheduling of interest payments, but without the problem of the principal being resolved. Early this year, the International Monetary Fund approved a new program for Brazil on the basis of a letter of intent submitted by the Government in December, 1991. In his statement to the Interim Committee, Planning Minister Marcilio Marques Moreira said the Government wanted an agreement with the banks on the country's public-sector medium- and long-term debt. But he wanted an agreement compatible with Brazil's "estimated debt service capacities." He noted that the very conclusion of the agreement on rescheduling interest rates arrears "led to a significant expansion of Brazilian firms' borrowing abroad through a variety of market instruments."

Once again, the research material is being examined at fora specially convened for this purpose. And again, a book is to be one of the outputs. Jointly edited by Griffith-Jones and Rodriguez, it is entitled: Tangled Webs: Cross-Conditionality, Banking Regulations and Third World Debt.

Debt Management System

Apart from the challenge of paying off the debt and finding resources for sustenance and development inspite of it, Third World countries face the more basic challenge of managing the debt. This involves passive debt management, having information about the debt — how much is owed to whom and how much needs to be paid when — and taking appropriate action on the basis of that information. It also involves a more active form of management — using the information for renegotiation and reconfiguration of the debt. Active management means, for example, knowing when and how to negotiate a new debt bearing less onerous interest and repayment terms to replace an existing debt. These are the kinds of management tasks efficient companies, even individuals, in the developed world undertake as a matter of course. Many Third World countries lack the means to perform such tasks.

Canada has struck a happy chord in this direction through the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS). This system revolves around a software programme developed by the Commonwealth Secretariat with financial and other support from IDRC. The Commons Standing Committee report refers to the project as an important contribution to fulfilling the goal to ensure that "each debtor country should be able to reach a satisfactorily sustainable level of external debt management on the basis of its own national resources." Among other things, the project has enabled a number of countries to end the practice of conducting debt negotiations solely on the basis of figures emanating from the other side of the bargaining table.

The system has already been established in 26 Commonwealth countries. In keeping with the Committee's recommendations that the effort should be widened, the Government has agreed that it should be made available to non-Commonwealth countries. IDRC and the Canadian International Development Agency (CIDA) are currently developing a program to make the benefits available to some non-English-speaking and other non-Commonwealth nations. The initial focus of the extended program will be on Francophone Sub-Saharan African countries.

The plight of Sub-Saharan Africa

Sub-Saharan Africa continues to provide the biggest challenge and the least hope. Brian O'Reilly contends: "Most of its 44 countries haven't got a prayer of catching up any time soon — they are paying only half the interest due on loans. Their economies depend on commodities and prices collapsed in the 1980s." Debt service was expected to require about 20 percent of the export earnings of Sub-Saharan African countries and nearly 40 percent of the export earnings of countries in North Africa and the Middle East. For Guinea-Bissau, to take one concrete example, debt service required between 40 and 65 percent of export earnings during the period 1985-91.

The most recent annual World Bank review of the Third World debt situation once again highlights Sub-Saharan Africa's disadvantage in the attempt to escape the debt trap. There are a number of reasons for this disadvantage. One is the fragile and undiversified nature of most economies in this region, which generally rely on a few primary

commodities. This places them at the mercy of the weather and/or a few key prices. Latin America's experience seems to suggest the importance of industrial capacity in reorienting the economy towards export-led growth and an increased capacity to meet external obligations. A second is the fact that such solutions as the Brady Plan focus only on commercial debt and therefore offer little help or hope to Sub-Saharan African countries which are mainly indebted to governments and multilateral financial institutions. The latter in particular have steadfastly refused to reschedule or cancel their loans, for fear of hurting their own capacity to raise funds.

A third factor is civil wars, of which Africa has more than its share. This is a critical factor in such problem cases as Liberia, Mozambique, Somalia and Sudan. Ironically, the encouraging moves towards democratic reforms in other countries may exacerbate this situation in the short run. Effective policy-making seems to be grinding to a halt as Niger undertakes constitutional reform, while civil unrest is disrupting Zaire. Also, a devastating drought has once again hit Southern Africa. Perhaps, the most worrisome prospect, however, is that of international marginalization. If the biggest Latin American debtors are no longer threatening the world's financial system, it may be all too easy for the world to turn its back on the continuing African struggle. The siren call of the fresher and closer East European crises may prove too much to resist.

Lessons Learned

There are at least four important lessons which arise from the experience provided by the crisis. The first is that the responsibility for action cannot be borne by one side only. Developing countries have a role to play in devising policies to help themselves grow out of the situation in which they find themselves. Equally, developed-country banks and governments must share the responsibility for the present difficulties and take part in corrective efforts. Token gestures to the Third World, with promises to return when they have grown out of their supposedly self-inflicted indebtedness is neither a humane or feasible approach. Ghanaian diplomat Dr J.L.S. Abbey explains, "Africa needs a growing out of debt strategy. It is equally clear that in spite of the progress so far achieved, the current international environment is not adequately supportive of such a strategy. The resolve of the international community needs to be strengthened to meet the challenges posed by debt, pervasive poverty and human suffering."

What is needed is nothing less than a comprehensive strategy that incorporates national adjustment measures; debt forgiveness to clear away the monetary rubble and create space for growth; and measures to facilitate a more symmetrical flow of trade and trade receipts and a lasting reversal of the capital outflow.

A second and related lesson derives from the persistence of the problem. The crisis will not go away of its own volition. Nor can it be

wished out of existence. Either we resolve it or it will remain to haunt us.

Thirdly, such efforts must include the multilateral development banks — the World Bank and regional banks serving Latin America, Asia, Africa and the Caribbean — and the International Monetary Fund. These institutions have also become part of the problem. In some cases today, there is a net flow of resources to these institutions from the Third World. Because of the economic power wielded by the World Bank and the IMF in particular, the tendency to default on indebtedness to these institutions is not as great. This should not, however, be allowed to mask the fact that, as part of a country's loan portfolio, indebtedness to these bodies invariably exacerbates the debt burden. This is particularly true of many countries in Africa and the Caribbean where such loans constitute a significant fraction of the total debt. Steps to forgive or otherwise reconfigure not only official bilateral loans from the West, but also debts to the multilateral financial institutions need to form part of a comprehensive solution.

Fourth is the need to ensure that not only debt relief measures, but the negotiation process itself match the capacity of debtor nations. For a small country to have to release its leading financial expert to negotiate one year's debt relief is manifestly wasteful if he or she will complete this process just in time to begin preparation for next year's exercise. Some very unkind words have been used to describe the debt negotiation process. According to Professors Uwe Holz and Jan Tinbergen, "the circus of international debt negotiation continues." While the world awaits any reforms in the negotiation process, much can be done by Third World governments, with appropriate international support, to improve their preparedness for and management of the process, and also to sharpen their debt management strategies. (Pages 38–39 describe some of IDRC's efforts in this and related areas).

Conclusion

The Standing Committee, in its report to the House of Commons, chose not to add a new debt relief initiative to the vast compendium of existing proposals. Further, the Committee "does not endorse any single diagnosis of, or prescription for, all of the ills of debtor countries in the developing world. Probably, elements from more than one approach will be needed, adapted to the particular situation of each country. But we have heard enough to be convinced that the status quo is not acceptable." In fact, the Committee seemed to mirror Roy Culpeper's sentiment that, "Perhaps now is the time for people in Canada to put a lot of thought into alternative approaches to debt reduction." We conclude this survey with brief comments on both aspects of Culpeper's proposition — the need for new initiatives and the role which Canada might play in developing them.

There is enough in what has been said before to support the position that, in seeking to understand and resolve the debt problem,

the world has not yet got it right. Even with the positive developments in some Latin American countries, the task — at both the conceptual and the operational levels — remains incomplete. This is obvious, for example, in the case of countries in Sub-Saharan Africa.

In many ways, Canada is almost uniquely placed to undertake a role in the resolution of this problem. Its own national interests are sufficiently close to the interests of banks in other western countries to allay fears that the latter's vital needs might be sacrificed. It has a sufficiently high and positive profile and acknowledged legitimacy in much of the developed world to serve, as it has begun to do, at least a limited advocacy role on their behalf. It belongs to all the right clubs — the G-7, the Commonwealth, La Francophonie and the higher councils of the international finance institutions. It therefore has access to the main actors on both sides of the debt crisis divide.

With the growing convergence of views on the matter and increasing evidence that an appropriate mix of international support and domestic policy could be effective, the time, as Culpeper says, is right. Now indeed seems the time to get fully engaged in one last, possibly grand, but certainly well-thought-out effort in which all are profitably involved, lest all should be ignominiously consumed.

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